

# **E-Book**

## **CARO 2020 - Decoding the Perspective**



**The Institute of Chartered Accountants of India**

(Set up by an Act of Parliament)

**Southern India Regional Council**

**Chennai**

# E-Book

## CARO 2020 - Decoding the Perspective

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**The Institute of Chartered Accountants of India**  
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**FOREWORD**

**CARO 2020** is a new format for issue of audit reports in case of statutory audits of companies under Companies Act, 2013. CARO 2020 has included additional reporting requirements after consultations with the National Financial Reporting Authority (NFRA). NFRA is an independent regulatory body for regulating the audit and accounting profession in India. The aim of CARO 2020 is to enhance the overall quality of reporting by the company auditors.

CARO 2020 has brought in significant change. Objective of the New CARO is to enhance the Trust in financial statements, since number of companies in India have failed which has shaken the investors' confidence.

Applicability of CARO 2020

- One person company
- Small Companies
- Banking Companies
- Insurance Companies
- Companies Registered for Charitable purposes
- Reporting Requirements under CARO 2020
- Details of tangible and intangible assets
- Details of inventory and working capital
- Details of investments, any guarantee or security or advances or loans given
- Compliance in respect of a loan to directors
- Compliance in respect of deposits accepted
- Maintenance of costing records
- Deposit of statutory liabilities
- Unrecorded Income
- Cash Losses
- Reporting regarding Fraud
- Funds raised and utilisation
- Compliance by a Nidhi

We are pleased to present before our members and other stakeholders this e-book, **Company Auditors Report Order (CARO), 2020- Decoding the perspective** covering all the above aspects.

On behalf of SIRC, I wish to place our sincere gratitude and appreciation to CA. Bhavana Mupparapu, for sharing her experience and expertise on the CARO 2020 amongst our members through this e-book. I also take the privilege of thanking CA. R Muthurajan for reviewing the basic draft of e-book and adding value to the substance of the e-book. The comments and suggestions on the e-book are welcome at [sirc@icai.in](mailto:sirc@icai.in)

**CA.China Masthan Talakayala**  
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# Company Auditor's Report Order CARO 2020- Decoding the Perspective



## **AMENDMENTS IN CARO, 2020**

Imagine a situation where you are required to drive a vehicle in unmanageable traffic conditions without even knowing the destination. The only instruction you know is to keep driving without stopping. Among others, we as Chartered Accountants, all the more cannot do the same as we are trained and wired to think skeptical and question the reasonability of the state of affairs. Now if we were to do the same in a more difficult situation where the penalties for violation of even the pettiest of the traffic rule also is humongous, would we still do it? Would we, as Chartered Accountants, assume such risk? I am sure most of us would respectfully decline such an offer irrespective of the expected return, isn't it?

With compliances of various regulatory bodies increasing by the day, the accountability and risk factor of Chartered Accountants has become directly proportional to the dynamic changes. Therefore, trying to implement the dynamic changes and amendments without understanding the bigger picture and macro level perspective would be equivalent to driving in the above referred situations.

The robust economic and business conditions in the economy steered by globalization and liberalization of trade practices that are witnessed by cross border business transactions, multi-national presence of various entities has necessitated the paradigm shift from Accounting Standards to Indian Accounting Standards and the well managed phased implementation covering most large entities moderately. The very underlying concept of Accounting Standards has been revamped from dictating specific treatments to more principal based and establishing broad rules under Indian Accounting Standards. However, these financial statements prepared as per Indian Accounting Standards also gain sanctity and reliability for various stakeholders only after they are signed and commented upon by the auditor by way of an Independent Auditors' Report accompanied by CARO (together referred to as Audit Report hereafter) where applicable.

Further, considerable instances of audit failures witnessed in the recent past as a result of mis presentation of financial statements and well-designed fraudulent schemes compel the need to update the Audit Report for more information and better reporting of the true status of Companies.

Thus, we as auditors are entrusted with great responsibility to summarize all our audit findings into our Audit Report to provide reasonable assurance to the stakeholders that the state of affairs of the entity are in order and that the entity in toto is compliant of various statutory requirements applicable. The decision making of the stakeholders is elicited largely from the observations reported in our report among other factors.



Therefore, when our Audit Report finds paramount place in the monetary decision-making process, the same ought to change to meet the emerging needs. Hence, **CARO 2020**.

## Recent changes in CARO 2020

### 1. Reporting requirements with respect to Tangible and intangible assets



a. The words “Tangible assets” is now replaced by the words “Property, Plant & Equipment” in order to match the terminology with that of global accounting language and financials prepared as per Indian Accounting Standards. This enables better understanding and removes any possible confusion for stakeholders who are not well versed with accounting jargon.

b. Inclusion of clause requiring reporting the maintenance of proper & full records of Intangible assets. Yes, the time has come for us to give more importance to intangible assets and treat them at par with tangible assets. With new forms of businesses budding at a rapid rate, intangible assets like trademarks, patents, brands, franchisees, intellectual property, copy rights,



Goodwill etc., have gained immense prominence. Also, these intangible assets carry substantial value and therefore have been assigned a separate clause in the Audit Report in CARO 2020. In order to report the same, we might have to consider collecting title documents for intangible assets for verification of ownership just as we do for tangible assets. However, the form, content, terms etc., of the ownership is expected to be quite different compared to that of tangible assets because of which we may have to rely on reports obtained from competent professionals. Further, it might be challenging to collect information in case of internally generated intangible assets like in-house development of software, apportioned cost of intangible assets purchased for a group of related companies etc. In such cases, we might collect the detailed cost records of every element in the process of asset creation / development process and verify the invoices to ensure that the company has rightful title.

Further, it is advisable to collect Management Representation Letter to ensure that they have reviewed the ownership of intangible assets and its valuations at regular intervals and that the title is free from litigations or impairments as part of our working papers file.

c. In CARO 2016, we were only required to specify whether or not the title deeds of immovable properties held by the company was in its own name or not. This clause has been slightly amended to include a tabular presentation of the list of immovable properties the title deeds of which are not in the name of the Company. The following is the table mandated

Description of the property	Gross carrying value	Held in the name of	Relationship	Period of holding	Reason for not being held in the name of the company

As can be seen, this table calls for detailed information as to why the title deeds are not in the name of the company and the relationship with such name holder. This new reporting intends to disclose related party transactions and thereby intends to report any possible violation of laws because of involvement of related parties.

This additional information can be collected in the process of verification of tangible and intangible assets and its ownership as per the previous clause itself. In case any reporting is required under this table, it is advisable to first establish the relationship of the company with the owner of the title and cross check the same from external sources like MCA website where possible. Next step would be to analyse the commercial elements of the transaction and critically evaluate the reasons for holding the property in the name of other entity / person and report accordingly.

- d. In case of Revaluation of assets during the year (including right of use of assets), we are now required to report if the valuation was carried out by a Registered Value and if the change in net carrying value is more than 10%, the amount of change of each asset class is to be reported in the Audit Report. The scope of this clause is further extended to include right of use of assets also. This is applicable in Lease contracts where “lessee may elect to apply that revaluation model to all of the right of use assets that relate to that class of property, plant and equipment.”

### REVALUATION OF FIXED ASSETS



The need for this clause is that revaluation of assets has become relatively normal in the present time and every time the assets are revalued, the net worth of the company is affected. This might have an impact on several aspects like deciding the applicability of various provisions, loan / overdraft facilities in banks and financial institutions, reporting requirements for Stock Exchanges etc.

As we would collect the valuation report as part of routine audit procedures in the event of revaluation of asset, no additional audit procedures are required for reporting of this clause. We may report the changes due to revaluation of assets for each class / block of assets separately for better presentation of information.



## 2. Reporting requirement with respect to pending litigations



Earlier, we were only required to report about unpaid statutory dues because of pending litigations. Now we are required to report about proceedings pending / initiated under the Benami Transactions (Prohibition) Act, 1988.

The perspective behind this amendment could be that any violation under this Act usually entails substantial financial outflows and may sometimes jeopardize the very existence of a company. Therefore, it is crucial to report the status of such pending proceedings fairly in the Audit Report.

In order to report this clause, we may verify the invoices in Legal expenses account and correlate the same with various pending litigations and collect a comprehensive list from the Company containing details like the crux of the proceedings, Authority before which the proceedings are pending, what is the likely impact of the verdict on the financials etc.

## 3. Reporting requirements with respect to Inventories

The subjectivity of materiality is removed, and we are now required to express our opinion on the appropriateness of the coverage and procedure adopted by the management for verification of inventory. Further, where discrepancies of more than 10% are observed by the management in aggregate of each class of inventories (in terms of value), we are required to mention if the same has been adequately dealt with in the books of account.

This is because inventories hold substantial value in the overall financial wellbeing of a company, and they must ideally not be subjected to the test of materiality. Therefore, any variation beyond the threshold of 10% constitutes sizeable value and considered prudent to report the same in our report.

In order to be able to report under this additional clause, we may rely on the audit reports issued by the internal auditors of the company. In cases when internal audit is not applicable to the company, we may conduct physical verification of stock in the first week of April and reconcile the same to match the stock as on 31<sup>st</sup> March of the year. We may also

Collect the inventory verification reports prepared by the management at the time of their verification and their findings duly signed on their letterheads and a Management Representation Letter stating that adequate measures have been taken to deal with discrepancies, if any. Where any differences are noticed, we may make note of the same for each category of inventory. We may further analyse the variances noticed by dividing the same into gross and net by way of factoring standard stock losses, misplaced inventories etc., and accordingly disclose in the Audit report.

#### **4. Reporting with respect to security for working capital limits**

If a company has working capital limits of more than ₹ 5 crores from any bank or financial institution that are secured against current assets of the company, we are now required to report whether quarterly statements submitted to the bank / financial institution in this regard are in conformity with books. If not, we are now required to report the details of the discrepancies.

This provision has been brought in light of the humungous financial frauds / bankruptcy of companies reported by banks over the recent few years. There were several instances in the past where some companies had submitted inflated current asset statements to the banks / financial institutions in order to keep their drawing power and cash credit limits maintained. This might warrant the banks / financial institutions to write off substantial amounts as NPAs in the event of non-repayment of borrowings by companies as there will not be sufficient current assets in substance to exercise the lien and recover the debt when the companies are unable to repay.

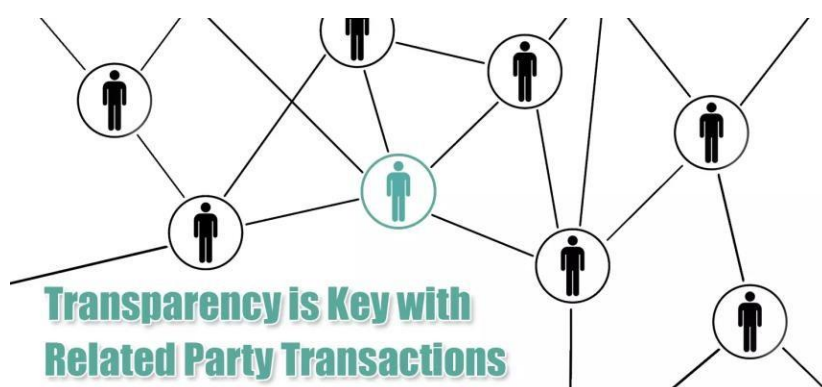
In order to meet this additional reporting requirements, we may request the company to send us a copy of the list of assets that are being pledged for lien and conduct physical verification of stock before submission of documents in the bank / financial institution. Alternatively, we may conduct surprise stock checks whenever possible during the year and correlate them with latest current assets statements submitted to banks / financial institutions to ensure the same have not been inflated. For companies where internal audit is applicable, we may rely on the reports of the internal auditors with respect to physical verification of stocks.

#### **5. Reporting with respect to Investments, loans and advances given**

The following disclosures are required to be given with respect to investments made, guarantees or security provided, and loans & advances granted.

- i.* Disclosure of aggregate amount and Outstanding Balance in respect of such Guarantee, Security or Loans & Advances to subsidiaries, Joint Venture and Associates. *(Modified)*

- ii. Disclosure of the aggregate amount and Outstanding Balance in respect of such Guarantee, Security or Loans & Advances to parties other than subsidiaries, Joint Venture and Associates. *(Modified)*
- iii. In case existing loans falling due during the year have been extended, renewed, replaced with fresh loans, specify the aggregate amount and percentage of such loans. *(Inserted)*
- iv. In case of loans or advances repayable on demand, without any terms or period of payment, specify the amount of such loans given to the promoters & related parties. *(Inserted)*



The reason behind inserting the two new sub-clauses quite apparently is to curb money laundering between related parties as related party transactions have been used as a tool to siphon money in several instances by creating shell companies. Further, auditors have always perceived the events such as frequent defaulting of loan payments, replacement of loans with fresh ones etc., as indicators for financial distress which could possibly lead to insolvency depending on the frequency and volume of borrowings. Therefore, it was time to introduce these clauses in the Audit report to express the seriousness of such instances in the businesses.

In order to be able to report under these clauses, we may have to carefully and critically examine all the transactions with related parties and not resort to sampling techniques for these accounts. With due consideration of the concept of watch dog not a blood hound, we may treat these limited accounts as an exception and conduct audit of related party transactions and defaulting loan / renewal without repayment loan cases with utmost skepticism. We may obtain confirmation of transactions and closing balances from auditors of related parties where transactions have taken place during the year and communicate findings that we may deem fit.

## 6. Reporting with respect to transactions not recorded

Under this clause we are required to report if there was any unreported income that was disclosed and added to income of the company during tax assessments.



This is because, it is quite normal that income declared by company in its return of income may be increased by additions made by Assessing Officer. However, when certain additions are substantial and recurring in nature, the company may have to give effect of such transactions in its books of account of substantial years. Therefore, it is important for us to report the same in our Audit report.

In order to report under this clause, we may login to the income tax e-filing portal of the company and check the status of all assessment proceedings, both pending and complete and accordingly report the same.

## 7. Reporting with respect to period and amount of default with respect to loans

Earlier, we were only required to report if there were any defaults in payment of interest or repayment of loan. Now, the following new sub-clauses have been introduced

- i. Lender wise details of defaults
- ii. Whether the lender has declared the company as wilful defaulter
- iii. Whether term loans / short term loans were utilised for the purpose for which they were obtained and deviations, if any
- iv. Details of funds procured by the company to meet the obligations of subsidiaries, joint ventures, and associates
- v. Whether the company has raised any loans on pledge of securities in the name of subsidiaries, joint ventures, and associates



These sub-clauses are introduced to report the end use of borrowed funds. One of the basic concepts of accounting - Matching concept stands violated under circumstances when interest bearing loans are taken by holding company and the funds are diverted to its group

Companies as interest free advances repayable on demand. This is in line with provisions of Section 14A and Rule 8D of Income Tax Act, 1961. Further, reporting about the end use of borrowed funds and deviations, if any, would also alarm the lender about the possibility of timely recoveries.

In order to be able to report under these newly inserted clauses, we may carefully verify all the loan disbursement documents and loan agreements to verify the schedule of assets pledged. Further, we may critically examine all the loan account statements correlating the same with related party accounts. We may compare all the payments towards loans during the year with loan repayment schedule to check for any defaults and report accordingly.

## **8. Reporting regarding fraud**



In this regard, we are additionally required to report if any findings have been filed in Form ADT-4 with the Central Government in relation to suspected offense /frauds. Further, we are also required to report if any whistle-blower complaints have been received during the year.

This clause is introduced as such circumstances are very serious and if the auditor has come across such findings during the course of audit, it definitely deserves a place in the Audit report in order to make the same apparent to banks/ financial institutions / other stakeholders.

Bringing such situations into light and obtaining substantial audit evidence to report under this clause could be very challenging for us as frauds, by definition are well designed acts usually with escape plans in place. In order to be able to report under this clause, we may review the whistle-blower policy of a company and call for all documented evidence. We may gather more information by way of informal communication with the employees by staying well within the boundaries established by the ethics committee. For companies where internal audit is applicable, we may rely on the same as they are more frequently involved into the audit of affairs of the company as compared to statutory auditors. We may also obtain a Management Representation Letter stating that no frauds have occurred during the financial and that there were no instances of whistleblowing.

## **9. Reporting with respect to Nidhi Companies**

We are now required to report whether there is any default in payment of interest on deposits or repayment thereof to Nidhi Companies.

This is because, Nidhi Companies are like Co-Operative Societies where all members function for the benefit of all. They are essentially non-commercial lending institutions for the welfare of its members and therefore is given special status and compliance reliefs even in Companies Act, 2013. Therefore, defaulting payments to such an entity is treated serious (similar to that of MSMEs) warranting reporting in the Audit report.

In order to be able to report under this clause, we may obtain the list of borrowings of the company from Nidhi Companies along with repayment schedules and compare both to find discrepancies / defaults, if any. We may also obtain account statement and closing balance confirmation from the Nidhi Company as external evidence for our verification.

#### **10. Reporting regarding internal audit**

We are now required to report if the internal audit system of a company, where applicable, is commensurate with the size of the company and if we have obtained and reviewed the internal audit reports.



This clause ought to have been included in the audit report from the time internal audit was made mandatory to certain class of companies. This is because, when dealing with large voluminous transactions of multinational companies, we inevitably rely on the reports of the internal auditors / branch auditors and therefore, it is crucial to know if the internal audit is commensurate with the size of the company.

We do not as such need to obtain any extra evidence to be able to report under this clause. As we collect copies of internal audit reports as part of our routine audit procedures, we may not be required to obtain any additional information for this clause. However, in cases where there is a requirement to complete statutory audits in the months of April / May itself, it would be challenging to collect internal audit reports as the internal audit would not have been

Completed by then. In such cases, the internal auditors may conduct continuous review of transactions of the last quarter alone in order to be able to deliver the internal audit report in time.

#### **11. Reporting with respect to registration under Reserve Bank of India**

We are now required to additionally report if any NBFC activities are being conducted without possessing registration u/s 45-IA of RBI Act and whether the company qualifies for a Core Investment Company.

Core Investment Companies (CICs) are specialized NBFCs that need to undergo NBFC registration with RBI. These CICs, which have an asset size of ₹ 100 crore and above, carry on the business of acquisition of shares and securities, subject to certain conditions.

The need for this clause is quite clear from the registration threshold that when a company is engaging into such high value NBFC activities, it shall have the requisite registrations in place to establish accountability and to get covered under the ambit of periodic reporting of information to respective regulatory authorities. It is very pertinent to have this clause in our Audit report with budding NBFCs taking birth in the recent times and to protect the interest of public at large.

In order to be able to report under this clause, we may check for ourselves from the books of account if the financing activities are crossing the threshold of ₹ 100 crores and if yes, we may obtain the registration certificate and check if periodic returns and forms have been filed with RBI under the RBI Act and report accordingly.

#### **12. Reporting with respect to Cash losses incurred during the year and immediately preceding year**



Under this newly inserted clause, we are required to report if the company had incurred any cash losses during the year and the immediately preceding financial year and also the quantum of loss / negative balance in the Cash Flow Statement.

This clause might have been introduced because as a general tendency most stakeholders look at the Profit and loss account & EPS and the banks / financial institutions may be interested in the income declared by the company in its computation statement. However, we all understand that there are numerable non-cash adjustments required as per Companies Act, 2013, Income Tax Act, 1961, Indian Accounting Standards / Indian GAAP etc., that may completely change the way the financial performance of the company is presented owing to various concepts of accrual basis of accounting, matching concept etc. Therefore, the often-ignored Cash Flow Statement is not brought into light and we are required to report the actual cash losses, if any.

In my opinion there is no additional audit documentation to be collected to report under this clause as it is something that is apparent from the financial statements and is only being brought to an important status. In cases where cash flow statement is not readily available, we may calculate the cash loss by adding non-cash transactions to Net profit as per Profit / Loss account like depreciation, amortization, deferred tax, and deferred expenditures, write backs etc.

### **13. Reporting with respect of Resignation of Auditors**

This clause requires us to report if there was any resignation of auditor during the year and if yes, whether issues, objections or concerns raised by the outgoing auditors have been appropriately dealt with.

This well-deserved clause might have been introduced to put a check on persuasive pressures imposed on auditors in certain cases and other situations compelling them to submit their resignation.

In order to report under this clause, along with the usual NOC obtained as per professional code of conduct, we may additionally request a letter of communication stating the reason for resignation from the outgoing auditor to be sure that the company is free from any wrong happenings in this perspective. In this regard, it is worthwhile to note the distinction between resignation of auditors and rotation of auditors. What is required to be reported is resignation of auditors, but not rotation of auditors.





#### 14. Reporting with respect to the uncertainties to meet liabilities

This is a newly inserted clause requiring the auditors to provide details of material uncertainty about realization of financial assets and repayment of financial liabilities, and whether such uncertainty exists on the date of Audit report and if the company will not be able to service its liabilities as and when they fall due within a period of one year from the date of Balance Sheet.

This clause can be better understood conjunctively with Indian Accounting Standard 10 (Events after reporting period) / Accounting Standard 4 (Contingencies and events occurring after the Balance Sheet date). There could be instances where occurrence of certain material events could jeopardize the financial soundness of the company and the company may not be in a financial position to repay its liabilities as and when they are due, but the management may exercise its judgment to not include relevant disclosures in the financial statements as they are not obligated to do so. Therefore, the need for Audit report. This reporting might significantly influence the decision-making process and enable the stakeholders to take an informed decision.

Reporting under this clause could be a little tricky as it is a highly objective matter and involves a severe degree of judgment to rightly assess the situation and the quantum of repercussions on the financials and the solvency of the company. Certain cases might also require reliance on reports of third-party reports / expert opinions by competent persons. We shall exercise our due diligence in placing our reliance and report accordingly. We may also calculate key financial ratios in order to ascertain the quantum / degree of financial distress and the disability of the company to pay off its liabilities. If the ratios indicate a threat to the going concern assumption of the company, we may also report the same in the main Audit report in addition to CARO report.

#### 15. Reporting with respect to Corporate Social Responsibility (CSR)



New clauses have been introduced requiring reporting whether in relation to ongoing CSR projects, unspent amount has been transferred to Special account within stipulated time as mandated by Section 135 of Companies Act, 2013. Further, we are also required to report the details of transfer of unspent CSR money with respect to other than ongoing projects as specified in Schedule VII within the stipulated period as per Section 135 of Companies Act, 2013.

This clause could have been introduced in line with the recent amendments in Companies Act, 2013 imposing penalties and prosecution of Directors in case of non-compliance with CSR provisions. Before implementation of these amendments, non-spending of the minimum required CSR expenditure only required mere reporting in the notes accompanying and forming part of financial statements without any penal provisions due to which the very purpose of Corporate Social Responsibility was defeated. Therefore, the above referred amendments were introduced to inculcate seriousness among big corporates towards their social responsibilities. Accordingly, it makes sense to introduce this reporting requirement in our Audit report as well.

In order to report under this clause, we may collect the CSR policy copy of the company and verify the amount spent in detail. Further, in respect of ongoing projects, we may collect technical reports from competent professionals estimating the balance outlay of funds required and whether the same is set aside in separate bank account and meets the minimum required spending. With respect to other than ongoing projects, we may collect the special bank account maintained for this purpose and verify the transactions therein.

**16. The clause with respect to the reporting of Managerial remuneration has been omitted from CARO 2020**



**Conclusion**

All of this said, each audit is different and dynamic. There cannot be hard and fast rules set to conclude a particular audit because audit itself is a highly subjective process. Due to well-crafted fraudulent activities coming into light each day, there could be instances where we might need to wear the skin of a blood hound and step outside the soul of a watch dog in order to protect our own interest too among the interest of various stakeholders and regulatory bodies.

Pure judgment and reliance on reports of other professionals may be required in more instances than we can think of, and we must remember the reason why the concept of Audit report is introduced in first place, and we must step into the shoes of the stakeholders and regulatory authorities to understand the end objective of the entire process. We must at all times keep our eyes, ears and trust our instincts and read & interpret any possible triggers, after all it is from these small factors that most big crimes are brought into light. This, however, does not mean that we end up harassing the companies by using nothing but entirely skeptical approach to conduct the audit. We must also understand the practical difficulties faced in the industry. The crux is to say, we are given utmost responsibility and accountability and the Audit report is an indispensable tool in our hands to express our opinion to stakeholders for their decision making.

***Disclaimer: This piece of work is purely based on my judgments and based on my opinion and understanding of the law and reporting requirements. This is not an actual representation of the legal interpretation but is only to express my views based on my practical experiences and exposures to various audits.***



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